

sponsor or employer to make a contribution measured in terms of cash amounts would constitute a prohibited transaction under section 406(a)(1)(A) of ERISA (and section 4975(c)(1)(A) of the Code) unless a statutory or administrative exemption under section 408 of ERISA (or sections 4975(c)(2) or (d) of the Code) applies. For example, if a profit sharing plan required the employer to make annual contributions “in cash or in kind” equal to a given percentage of the employer’s net profits for the year, an in-kind contribution used to reduce this obligation would constitute a prohibited transaction in the absence of an exemption because the amount of the contribution obligation is measured in terms of cash amounts (a percentage of profits) even though the terms of the plan purport to permit in-kind contributions.

Conversely, a transfer of unencumbered property to a welfare benefit plan that does not relieve the sponsor or employer of any present or future obligation to make a contribution that is measured in terms of cash amounts would not constitute a prohibited transaction under section 406(a)(1)(A) of ERISA or section 4975(c)(1)(A) of the Code. The same principles apply to defined contribution plans that are not subject to the minimum funding requirements of section 302 of ERISA or section 412 of the Code. For example, where a profit sharing or stock bonus plan, by its terms, is funded solely at the discretion of the sponsoring employer, and the employer is not otherwise obligated to make a contribution measured in terms of cash amounts, a contribution of unencumbered real property would not be a prohibited sale or exchange between the plan and the employer. If, however, the same employer had made an enforceable promise to make a contribution measured in terms of cash amounts to the plan, a subsequent contribution of unencumbered real property made to offset such an obligation would be a prohibited sale or exchange.

(d) *Fiduciary standards.* Independent of the application of the prohibited transaction provisions, fiduciaries of plans covered by part 4 of title I of ERISA must determine that acceptance of an in-kind contribution is consistent with ERISA’s general standards of fiduciary conduct. It is the view of the Department that acceptance of an in-kind contribution is a fiduciary act subject to section 404 of ERISA. In this regard, sections 406(a)(1)(A) and (B) of ERISA require that fiduciaries discharge their duties to a plan solely in the interests of the participants and beneficiaries, for the exclusive purpose of providing benefits and defraying reasonable administrative expenses, and with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character

and with like aims. In addition, section 406(a)(1)(C) requires generally that fiduciaries diversify plan assets so as to minimize the risk of large losses. Accordingly, the fiduciaries of a plan must act “prudently,” “solely in the interest” of the plan’s participants and beneficiaries and with a view to the need to diversify plan assets when deciding whether to accept in-kind contributions. If accepting an in-kind contribution is not “prudent,” not “solely in the interest” of the participants and beneficiaries of the plan, or would result in an improper lack of diversification of plan assets, the responsible fiduciaries of the plan would be liable for any losses resulting from such a breach of fiduciary responsibility, even if a contribution in kind does not constitute a prohibited transaction under section 406 of ERISA. In this regard, a fiduciary should consider any liabilities appurtenant to the in-kind contribution to which the plan would be exposed as a result of acceptance of the contribution.

[59 FR 66736, Dec. 28, 1994]

§ 2509.95-1 Interpretive bulletin relating to the fiduciary standard under ERISA when selecting an annuity provider.

(a) *Scope.* This Interpretive Bulletin provides guidance concerning certain fiduciary standards under part 4 of title I of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1104-1114, applicable to the selection of annuity providers for the purpose of pension plan benefit distributions where the plan intends to transfer liability for benefits to the annuity provider.

(b) *In General.* Generally, when a pension plan purchases an annuity from an insurer as a distribution of benefits, it is intended that the plan’s liability for such benefits is transferred to the annuity provider. The Department’s regulation defining the term “participant covered under the plan” for certain purposes under title I of ERISA recognizes that such a transfer occurs when the annuity is issued by an insurance company licensed to do business in a State. 29 CFR 2510.3-3(d)(2)(ii). Although the regulation does not define the term “participant” or “beneficiary” for purposes of standing to bring an action under ERISA § 502(a), 29 U.S.C. 1132(a), it makes clear that the purpose of a benefit distribution annuity is to transfer the plan’s liability with respect to the individual’s benefits to the annuity provider.

Pursuant to ERISA section 404(a)(1), 29 U.S.C. 1104(a)(1), fiduciaries must discharge their duties with respect to the plan solely in the interest of the participants and beneficiaries. Section 404(a)(1)(A), 29 U.S.C. 1104(a)(1)(A), states that the fiduciary must act for the exclusive purpose of providing

benefits to the participants and beneficiaries and defraying reasonable plan administration expenses. In addition, section 404(a)(1)(B), 29 U.S.C. 1104(a)(1)(B), requires a fiduciary to act with the care, skill, prudence and diligence under the prevailing circumstances that a prudent person acting in a like capacity and familiar with such matters would use.

(c) Selection of Annuity Providers. The selection of an annuity provider for purposes of a pension benefit distribution, whether upon separation or retirement of a participant or upon the termination of a plan, is a fiduciary decision governed by the provisions of part 4 of title I of ERISA. In discharging their obligations under section 404(a)(1), 29 U.S.C. 1104(a)(1), to act solely in the interest of participants and beneficiaries and for the exclusive purpose of providing benefits to the participants and beneficiaries as well as defraying reasonable expenses of administering the plan, fiduciaries choosing an annuity provider for the purpose of making a benefit distribution must take steps calculated to obtain the safest annuity available, unless under the circumstances it would be in the interests of participants and beneficiaries to do otherwise. In addition, the fiduciary obligation of prudence, described at section 404(a)(1)(B), 29 U.S.C. 1104(a)(1)(B), requires, at a minimum, that plan fiduciaries conduct an objective, thorough and analytical search for the purpose of identifying and selecting providers from which to purchase annuities. In conducting such a search, a fiduciary must evaluate a number of factors relating to a potential annuity provider's claims paying ability and creditworthiness. Reliance solely on ratings provided by insurance rating services would not be sufficient to meet this requirement. In this regard, the types of factors a fiduciary should consider would include, among other things:

- (1) The quality and diversification of the annuity provider's investment portfolio;
- (2) The size of the insurer relative to the proposed contract;
- (3) The level of the insurer's capital and surplus;
- (4) The lines of business of the annuity provider and other indications of an insurer's exposure to liability;
- (5) The structure of the annuity contract and guarantees supporting the annuities, such as the use of separate accounts;
- (6) The availability of additional protection through state guaranty associations and the extent of their guarantees. Unless they possess the necessary expertise to evaluate such factors, fiduciaries would need to obtain the advice of a qualified, independent expert. A fiduciary may conclude, after conducting an appropriate search, that more than one annuity provider is able to offer the safest annuity available.

(d) Costs and Other Considerations. The Department recognizes that there are situations where it may be in the interest of the participants and beneficiaries to purchase other than the safest available annuity. Such situations may occur where the safest available annuity is only marginally safer, but disproportionately more expensive than competing annuities, and the participants and beneficiaries are likely to bear a significant portion of that increased cost. For example, where the participants in a terminating pension plan are likely to receive, in the form of increased benefits, a substantial share of the cost savings that would result from choosing a competing annuity, it may be in the interest of the participants to choose the competing annuity. It may also be in the interest of the participants and beneficiaries to choose a competing annuity of the annuity provider offering the safest available annuity is unable to demonstrate the ability to administer the payment of benefits to the participants and beneficiaries. The Department notes, however, that increased cost or other considerations could never justify putting the benefits of annuitized participants and beneficiaries at risk by purchasing an unsafe annuity.

In contrast to the above, a fiduciary's decision to purchase more risky, lower-priced annuities in order to ensure or maximize a reversion of excess assets that will be paid solely to the employer-sponsor in connection with the termination of an over-funded pension plan would violate the fiduciary's duties under ERISA to act solely in the interest of the plan participants and beneficiaries. In such circumstances, the interests of those participants and beneficiaries who will receive annuities lies in receiving the safest annuity available and other participants and beneficiaries have no countervailing interests. The fiduciary in such circumstances must make diligent efforts to assure that the safest available annuity is purchased.

Similarly, a fiduciary may not purchase a riskier annuity solely because there are insufficient assets in a defined benefit plan to purchase a safer annuity. The fiduciary may have to condition the purchase of annuities on additional employer contributions sufficient to purchase the safest available annuity.

(e) Conflicts of Interest. Special care should be taken in reversion situations where fiduciaries selecting the annuity provider have an interest in the sponsoring employer which might affect their judgment and therefore create the potential for a violation of ERISA § 406(b)(1). As a practical matter, many fiduciaries have this conflict of interest and therefore will need to obtain and follow independent expert advice calculated to identify those insurers with the

highest claims-paying ability willing to write the business.

[60 FR 12329, Mar. 6, 1995]

§ 2509.96-1 Interpretive bulletin relating to participant investment education.

(a) *Scope.* This interpretive bulletin sets forth the Department of Labor's interpretation of section 3(21)(A)(ii) of the Employee Retirement Income Security Act of 1974, as amended (ERISA), and 29 CFR 2510.3-21(c) as applied to the provision of investment-related educational information to participants and beneficiaries in participant-directed individual account pension plans (*i.e.*, pension plans that permit participants and beneficiaries to direct the investment of assets in their individual accounts, including plans that meet the requirements of the Department's regulations at 29 CFR 2550.404c-1).

(b) *General.* Fiduciaries of an employee benefit plan are charged with carrying out their duties prudently and solely in the interest of participants and beneficiaries of the plan, and are subject to personal liability to, among other things, make good any losses to the plan resulting from a breach of their fiduciary duties. ERISA sections 403, 404 and 409, 29 U.S.C. 1103, 1104, and 1109. Section 404(c) of ERISA provides a limited exception to these rules for a pension plan that permits a participant or beneficiary to exercise control over the assets in his or her individual account. The Department of Labor's regulation, at 29 CFR 2550.404c-1, describes the kinds of plans to which section 404(c) applies, the circumstances under which a participant or beneficiary will be considered to have exercised independent control over the assets in his or her account, and the consequences of a participant's or beneficiary's exercise of such control.¹

With both an increase in the number of participant-directed individual account plans and the number of investment options available to participants and beneficiaries under such plans, there has been an increase

in recognition of the importance of providing participants and beneficiaries, whose investment decisions will directly affect their income at retirement, with information designed to assist them in making investment and retirement-related decisions appropriate to their particular situations. Concerns have been raised, however, that the provision of such information may in some situations be viewed as rendering "investment advice for a fee or other compensation," within the meaning of ERISA section 3(21)(A)(ii), thereby giving rise to fiduciary status and potential liability under ERISA for investment decisions of plan participants and beneficiaries.

In response to these concerns, the Department of Labor is clarifying herein the applicability of ERISA section 3(21)(A)(ii) and 29 CFR 2510.3-21(c) to the provision of investment-related educational information to participants and beneficiaries in participant directed individual account plans.² In providing this clarification, the Department does not address the "fee or other compensation, direct or indirect," which is a necessary element of fiduciary status under ERISA section 3(21)(A)(ii).³

(c) *Investment Advice.* Under ERISA section 3(21)(A)(ii), a person is considered a fiduciary with respect to an employee benefit plan to the extent that person "renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority to do so * * *." The Department issued a regulation, at 29 CFR 2510.3-21(c), describing the circumstances under which a person will be considered to be rendering

²Issues relating to the circumstances under which information provided to participants and beneficiaries may affect a participant's or beneficiary's ability to exercise independent control over the assets in his or her account for purposes of relief from fiduciary liability under ERISA section 404(c) are beyond the scope of this interpretive bulletin. Accordingly, no inferences should be drawn regarding such issues. See 29 CFR 2550.404c-1(c)(2). It is the view of the Department, however, that the provision of investment-related information and material to participants and beneficiaries in accordance with paragraph (d) of this interpretive bulletin will not, in and of itself, affect the availability of relief under section 404(c).

³The Department has expressed the view that, for purposes of section 3(21)(A)(ii), such fees or other compensation need not come from the plan and should be deemed to include all fees or other compensation incident to the transaction in which the investment advice has been or will be rendered. See A.O. 83-60A (Nov. 21, 1983); *Reich v. McManus*, 883 F. Supp. 1144 (N.D. Ill. 1995).

¹The section 404(c) regulation conditions relief from fiduciary liability on, among other things, the participant or beneficiary being provided or having the opportunity to obtain sufficient investment information regarding the investment alternatives available under the plan in order to make informed investment decisions. Compliance with this condition, however, does not require that participants and beneficiaries be offered or provided either investment advice or investment education, *e.g.* regarding general investment principles and strategies, to assist them in making investment decisions. 29 CFR 2550.404c-1(c)(4).